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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9563]

RIN 1545-BI45

Guidance Regarding Foreign Base Company Sales Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance relating to foreign base company sales income when personal property sold by a controlled foreign corporation (CFC) is purchased, sold, manufactured, produced, constructed, grown or extracted by one or more branches of the CFC. The regulations finalize proposed regulations and withdraw temporary regulations published on December 29, 2008. These regulations, in general, affect controlled foreign corporations and their United States shareholders.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Applicability Date: These regulations apply to taxable years of CFCs beginning after June 30, 2009, and for taxable years of United States shareholders in which or with which such taxable years of the CFCs end.

FOR FURTHER INFORMATION CONTACT: Barbara E. Rasch, (202) 622-3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On February 28, 2008, the IRS and the Treasury Department published a notice of proposed rulemaking in the **Federal Register** (REG-124590-07, 2008-16 IRB 801, 73 FR 10716, as corrected at 73 FR 20201), which proposed amendments to §1.954-3, including rules that addressed the application of the section 954(d)(2) branch rules under the foreign base company sales income (FBCSI) rules. Written comments were received in response to the notice of proposed rulemaking, and a public hearing on the proposed regulations was held on July 29, 2008. On December 29, 2008, the IRS and the Treasury Department published final and temporary regulations under section 954(d) (TD 9438, 73 FR 79334-01, as corrected at 74 FR 11843-01) in the **Federal Register**. On the same date, the IRS and the Treasury Department published a notice of proposed rulemaking (REG-150066-08, 2009-5 IRB 423, 73 FR 79421-01) in the **Federal Register** cross-referencing the temporary regulations. The temporary and proposed regulations address the treatment under the FBCSI rules of the sale by a CFC of personal property that is purchased, sold, manufactured, produced, constructed, grown or extracted by one or more branches of the CFC. Written comments were received, and are available at www.regulations.gov or upon request. A public hearing was not requested and none was held. This Treasury decision adopts the proposed regulation with the changes described below as a final regulation and removes the corresponding temporary regulations.

Explanation of Provisions

These regulations amend the provisions of §1.954-3(b) that address the application of the FBCSI rules to CFCs with branches or similar establishments (branches), and, in particular manufacturing branches.

A. Branch Rule

Section 954(d)(1) defines FBCSI to mean income derived by a CFC in connection with: (i) the purchase of personal property from a related person and its sale to any person; (ii) the sale of personal property to any person on behalf of a related person; (iii) the purchase of personal property from any person and its sale to a related person; or (iv) the purchase of personal property from any person on behalf of a related person, provided (in all of these cases) that the property is manufactured, produced, grown or extracted outside of the CFC's country of organization and is sold for use, consumption or disposition outside of such country. There are certain exceptions to the FBCSI rules, including an exception that applies if a CFC sells personal property that it manufactured, produced, constructed, grew or extracted. See section 954(d)(1)(A), §1.954-3(a)(4).

Section 954(d)(2) applies the FBCSI rules to a CFC that has a branch outside the CFC's country of incorporation (branch rule). The branch rule applies if the CFC carries on purchasing, selling, manufacturing, producing, constructing, growing or extracting activities by or through the branch, and the carrying on of such activities has substantially the same tax effect as if the branch were a wholly-owned subsidiary of the CFC, as provided in regulations. If so, the branch and the remainder of the CFC will be treated as separate corporations for purposes of determining FBCSI of such CFC.

The “substantially same tax effect” determination is made pursuant to a tax rate disparity test set forth in §1.954-3(b)(1)(i)(b) and §1.954-3(b)(1)(ii)(b). With respect to a sales or purchase branch, the tax rate disparity test is applied by comparing the rate of tax imposed on the income derived from the purchasing or selling activities of the branch with the rate of tax that would apply if the income were earned by the remainder of the CFC. With respect to a manufacturing branch, the tax rate disparity test is applied by comparing the rate of tax imposed on the income derived from the purchasing and selling activities of the CFC with the rate of tax that would apply to such income under the laws of the country in which the manufacturing branch is located.

These final regulations provide guidance on the application of the branch rule, in particular with respect to a CFC that has multiple branches. For example, the regulations set forth rules on how to determine whether a CFC earns FBCSI if purchase and sales activities are conducted by multiple branches and if multiple branches are involved in the manufacture of either a single or multiple items of personal property that is sold by the CFC.

B. Summary of Comments

1. Demonstrably greater contribution

Section 1.954-3T(b)(1)(ii)(c)(3)(iii) provides that if none of the branches or the remainder of a CFC independently satisfies the substantial contribution test, but the CFC as a whole made a substantial contribution, then for purposes of applying the tax rate disparity test, the location of manufacture, production or construction is the “tested manufacturing location” unless the “tested sales location” provided a “demonstrably greater” contribution. Comments were received seeking clarification on the meaning of

the word “demonstrably” and expressing concern that it could be interpreted to provide an evidentiary rule regarding the standard of proof required with respect to the determination of the location of manufacture of an item pursuant to §1.954-3T(b)(1)(ii)(c)(3)(iii). The IRS and the Treasury Department did not intend the word “demonstrably” to refer to an elevated standard of proof. In order to eliminate uncertainty, the word “demonstrably” has been deleted from §1.954-3(b)(1)(ii)(c)(3)(iii).

2. Grouping of branches

Comments sought clarification of the rule in §1.954-3T(b)(2)(ii)(a) that generally provides for the grouping of branches that do not have tax rate disparity with a purchasing or selling branch, or with the remainder of the CFC treated as purchasing or selling on behalf of a manufacturing branch. This grouping rule applies for purposes of §1.954-3T(b)(2)(ii), which sets forth the rules that apply after it has been determined that a branch and the remainder of a CFC will be treated as separate corporations. Comments suggested that this grouping rule could be interpreted to group not only the activities of the branches but also the income of those branches and recommended that the rule be clarified by specifically stating that the rule groups the “activities” of the relevant branches.

The rules in §1.954-3T(b)(2)(ii) apply to determine whether the income of a branch or remainder of a CFC is FBCSI rather than to determine the amount of the income of the branch or remainder of the CFC. The purpose of this grouping rule is to allow a CFC to aggregate the activities of branches that do not have tax rate disparity with a sales or purchasing branch (or remainder) when applying the separate corporation analysis to determine whether the sales income of the sales or purchase

branch (or remainder) is FBCSI. §1.954-3(b)(1)(ii)(c)(3)(v), Example 1. The IRS and the Treasury Department believe that the grouping rule in §1.954-3T(b)(2)(ii)(a) properly aggregates the activities of the relevant branches (or remainder). However, for clarity, the phrase “the activities of” was added to §1.954-3(b)(2)(ii)(a).

C. Deletion of §1.954-3(b)(2)(ii)(d)

The final regulations delete paragraph (d) of §1.954-3(b)(2)(ii), which provided that income that is FBCSI as a result of the application of §1.954-3(b)(1)(i) (purchasing or selling branch rules) is not again classified as FBCSI as a result of the application of §1.954-3(b)(1)(ii) (manufacturing branch rules). This paragraph is no longer needed as a result of the addition of the rule in §1.954-3(b)(1)(ii)(c)(1), which provides that if one or more sales or purchasing branches are used in addition to a manufacturing branch, then only the manufacturing branch rules apply.

D. Future Guidance

The IRS and the Treasury Department continue to study additional FBCSI issues, and are considering whether to issue additional guidance, including guidance regarding when a branch should be treated as a separate corporation under section 954(d)(2), and the scope of, and relationship between, FBCSI and foreign base company services income. The IRS and the Treasury Department welcome comments on these issues.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866; therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative

Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. In addition, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply because the regulations do not impose a collection of information on small entities. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final and temporary regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Barbara E. Rasch of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income Taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for 26 CFR part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.954-3 is amended by:

1. Revising paragraphs (b)(1)(i)(c), (b)(1)(ii)(a), and (b)(1)(ii)(c).
2. Revising paragraphs (b)(2)(i)(b), (b)(2)(ii)(a), and (b)(2)(ii)(b).
3. Removing and reserving paragraph (b)(2)(ii)(d).
4. Revising paragraph (b)(2)(ii)(e).

5. Revising paragraph (b)(4) introductory text.
5. Revising Example 3 in paragraph (b)(4).
6. Adding Examples 8 and 9 in paragraph (b)(4).
7. Revising paragraphs (c) and (d).

The revisions and additions read as follows:

§1.954-3 Foreign base company sales income.

* * * * *

(b) * * *

(1) * * *

(i) * * *

(c) Use of more than one branch. If a controlled foreign corporation carries on purchasing or selling activities by or through more than one branch or similar establishment located outside the country under the laws of which such corporation is created or organized, then paragraph (b)(1)(i)(b) of this section shall be applied separately to the income derived by each such branch or similar establishment (by treating such purchasing or selling branch or similar establishment as if it were the only branch or similar establishment of the controlled foreign corporation and as if any such other branches or similar establishments were separate corporations) in determining whether the use of such branch or similar establishment has substantially the same tax effect as if such branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation. See paragraph (b)(1)(ii)(c)(1) of this section for rules applicable to a controlled foreign corporation that carries on purchase or sales activities by or through one or more branches or similar establishments in

addition to carrying on manufacturing activities by or through one or more branches or similar establishments.

(ii) Manufacturing branch--(a) In general. If a controlled foreign corporation carries on manufacturing, producing, constructing, growing, or extracting activities by or through a branch or similar establishment located outside the country under the laws of which such corporation is created or organized and the use of the branch or similar establishment for such activities with respect to personal property purchased or sold by or through the remainder of the controlled foreign corporation has substantially the same tax effect as if the branch or similar establishment were a wholly owned subsidiary corporation of such controlled foreign corporation, the branch or similar establishment and the remainder of the controlled foreign corporation will be treated as separate corporations for purposes of determining the foreign base company sales income of such corporation. See section 954(d)(2). The provisions of this paragraph (b)(1)(ii) will apply only if the controlled foreign corporation (including any branches or similar establishments of such controlled foreign corporation) manufactures, produces, or constructs such personal property within the meaning of paragraph (a)(4)(i) of this section, or carries on growing or extracting activities with respect to such personal property.

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(c) Use of more than one branch--(1) Use of one or more sales or purchase branches in addition to a manufacturing branch. If, with respect to personal property manufactured, produced, constructed, grown, or extracted by or through a branch or similar establishment located outside the country under the laws of which the controlled

foreign corporation is created or organized, purchasing or selling activities are carried on by or through more than one branch or similar establishment, or by or through one or more branches or similar establishments located outside such country, of such corporation, then paragraph (b)(1)(ii)(b) of this section shall be applied separately to the income derived by each such purchasing or selling branch or similar establishment (by treating such purchasing or selling branch or similar establishment as though it alone were the remainder of the controlled foreign corporation) for purposes of determining whether the use of such manufacturing, producing, constructing, growing, or extracting branch or similar establishment has substantially the same tax effect as if such branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation. If this rule applies, the sales or purchase branch rules contained in paragraph (b)(1)(i) of this section do not apply. The application of this paragraph (b)(1)(ii)(c)(1) is illustrated by the following example:

Example. All activities of controlled foreign corporation conducted through sales branches and manufacturing branch. (i) Facts. FS, a controlled foreign corporation organized under the laws of country M, operates three branches. Branch A, located in country A, manufactures Product X under the principles of paragraph (a)(4)(i) of this section. Branch B, located in Country B, sells Product X manufactured by Branch A to customers for use outside of Country B. Branch C, located in Country C sells Product X manufactured by Branch A to customers for use outside of Country C. FS does not conduct any manufacturing or selling activities apart from the activities of Branches A, B and C. Country M imposes an effective rate of tax on sales income of 0%. Country A imposes an effective rate of tax on sales income of 20%. Country B imposes an effective rate of tax on sales income of 20%. Country C imposes an effective rate of tax on sales income of 18%.

(ii) Result. Pursuant to this paragraph (b)(1)(ii)(c)(1), paragraph (b)(1)(ii)(b) of this section is applied to the sales income derived by Branch B by treating Branch B as though it alone were the remainder of the controlled foreign corporation. The use of Branch B does not have the same tax effect as if Branch B were a wholly owned subsidiary of FS because the tax rate applicable to the income allocated to Branch B under paragraph (b)(1)(ii)(b) of this section (20%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income

under the laws of Country A (20%), the country in which Branch A is located. In addition, paragraph (b)(1)(ii)(b) of this section is applied separately to the sales income derived by Branch C by treating Branch C as though it alone were the remainder of the controlled foreign corporation. The use of Branch C does not have the same tax effect as if Branch C were a wholly owned subsidiary of FS because the tax rate applicable to the income allocated to Branch C under paragraph (b)(1)(ii)(b) of this section (18%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income under the laws of Country A (20%), the country in which Branch A is located. Pursuant to this paragraph (b)(1)(ii)(c)(1), the rules under paragraph (b)(1)(i) of this section for determining whether a sales or purchase branch is treated as a separate corporation from the remainder of the controlled foreign corporation do not apply.

(2) Use of more than one branch to manufacture, produce, construct, grow, or extract separate items of personal property. If a controlled foreign corporation carries on manufacturing, producing, constructing, growing, or extracting activities with respect to separate items of personal property by or through more than one branch or similar establishment located outside the country under the laws of which such corporation is created or organized, then paragraphs (b)(1)(ii)(b) and (c) of this section will be applied separately to each such branch or similar establishment (by treating such manufacturing branch or similar establishment as if it were the only such branch or similar establishment of the controlled foreign corporation and as if any other such branches or similar establishments were separate corporations) for purposes of determining whether the use of such branch or similar establishment has substantially the same tax effect as if such branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation. The application of this paragraph (b)(1)(ii)(c)(2) is illustrated by the following example:

Example. Multiple branches that satisfy paragraph (a)(4)(i). (i) Facts. FS is a controlled foreign corporation organized in Country M. FS operates two branches, Branch A and Branch B located in Country A and Country B, respectively. Branch A and Branch B each manufacture separate items of personal property (Product X and Product Y, respectively) within the meaning of paragraph (a)(4)(ii) or (iii) of this section.

Raw materials used in the manufacture of Product X and Product Y are purchased by FS from an unrelated person. FS engages in activities in Country M to sell Product X and Product Y to a related person for use, disposition or consumption outside of Country M. Employees of FS located in Country M perform only sales functions. The effective rate of tax imposed in Country M on the income from the sales of Product X and Product Y is 10%. Country A imposes an effective rate of tax on sales income of 20%. Country B imposes an effective rate of tax on sales income of 12%.

(ii) Result. Pursuant to this paragraph (b)(1)(ii)(c)(2), paragraph (b)(1)(ii)(b) of this section is applied separately to Branch A and Branch B with respect to the sales income of FS attributable to Product X (manufactured by Branch A) and Product Y (manufactured by Branch B). Because the effective rate of tax on FS's sales income from the sale of Product X in Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch A is located (20%), the use of Branch A to manufacture Product X has substantially the same tax effect as if Branch A were a wholly owned subsidiary corporation of FS. Because the effective rate of tax on FS's sales income from the sale of Product Y in Country M (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch B is located (12%), the use of Branch B to manufacture Product Y does not have substantially the same tax effect as if Branch B were a wholly owned subsidiary corporation of FS. Consequently, only Branch A is treated as a separate corporation apart from the remainder of FS for purposes of determining foreign base company sales income from the sales of Product X.

(3) Use of more than one manufacturing branch, or one or more manufacturing branches and the remainder of the controlled foreign corporation, to manufacture, produce, or construct the same item of personal property--(i) In general. This paragraph (b)(1)(ii)(c)(3) applies to determine the location of manufacture, production, or construction of personal property for purposes of applying paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section where more than one branch or similar establishment of a controlled foreign corporation, or one or more branches or similar establishments of a controlled foreign corporation and the remainder of the controlled foreign corporation, each engage in manufacturing, producing, or constructing activities with respect to the same item of personal property which is then sold by the controlled foreign corporation. This paragraph (b)(1)(ii)(c)(3) is applied separately with respect to the income derived

by each purchasing or selling branch or similar establishment or purchasing or selling remainder of the controlled foreign corporation as provided under paragraphs (b)(1)(i) and (b)(1)(ii) of this section. The location of manufacture, production, or construction is determined under paragraph (b)(1)(ii)(c)(3)(ii) of this section if one or more branches or similar establishments or the remainder of the controlled foreign corporation independently satisfies paragraph (a)(4)(i) of this section with respect to an item of personal property. The location of manufacture, production, or construction is determined under paragraph (b)(1)(ii)(c)(3)(iii) of this section if none of the branches or similar establishments or the remainder of the controlled foreign corporation independently satisfies paragraph (a)(4)(i) of this section with respect to an item of personal property, but the controlled foreign corporation as a whole makes a substantial contribution to the manufacture, production or construction of that property within the meaning of paragraph (a)(4)(iv) of this section. For purposes of this paragraph (b)(1)(ii)(c)(3), the location of any activity with respect to the manufacture, production, or construction of an item of personal property is determined under paragraph (b)(1)(ii)(c)(3)(iv) of this section. For purposes of this paragraph (b)(1)(ii)(c)(3), if multiple branches or similar establishments are located in a single jurisdiction, then the activities of those branches will be aggregated for purposes of determining whether a branch or remainder of the controlled foreign corporation satisfies paragraph (a)(4)(i) of this section.

(ii) Manufacture, production, or construction in one or more locations. If only one branch or similar establishment or only the remainder of a controlled foreign corporation independently satisfies paragraph (a)(4)(i) of this section with respect to an item of

personal property, then that branch or similar establishment or the remainder of the controlled foreign corporation will be the location of manufacture, production, or construction of that property for purposes of applying paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section to the income from the sale of that property. See paragraph (b)(1)(ii)(c)(3)(v) Example 1 of this section. If more than one branch or similar establishment or one or more branches or similar establishments and the remainder of the controlled foreign corporation, each independently satisfy paragraph (a)(4)(i) of this section with respect to an item of personal property, then the location of manufacture, production, or construction of that property for purposes of applying paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section will be the location of that branch or similar establishment or the jurisdiction under the laws of which the remainder of the controlled foreign corporation is organized that satisfies paragraph (a)(4)(i) of this section and that would, after applying paragraph (b)(1)(ii)(b) of this section to such branch or similar establishment or paragraph (b)(1)(i)(b) of this section to the remainder of the controlled foreign corporation, impose the lowest effective rate of tax on the income allocated to such branch or the remainder of the controlled foreign corporation under such section (that is, either paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section). See paragraph (b)(1)(ii)(c)(3)(v) Example 2 of this section.

(iii) No location independently satisfies manufacturing test. If no branch or similar establishment or the remainder of the controlled foreign corporation independently satisfies paragraph (a)(4)(i) of this section with respect to an item of personal property but the controlled foreign corporation as a whole makes a substantial contribution to the manufacture, production, or construction of that property within the

meaning of paragraph (a)(4)(iv) of this section, then for purposes of applying paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section, the location of manufacture, production, or construction with respect to the income derived by a purchasing or selling branch or similar establishment or the purchasing or selling remainder of the controlled foreign corporation in connection with the purchase or sale of that property will be the “tested manufacturing location” unless the “tested sales location” provides a greater contribution to the manufacture, production, or construction of the property. The tested manufacturing location is the location of any branch or similar establishment or remainder of the controlled foreign corporation that contributes to the manufacture, production, or construction of the personal property, if any, that would, after applying paragraph (b)(1)(ii)(b) of this section to such branch or similar establishment or paragraph (b)(1)(i)(b) of this section to the remainder of the controlled foreign corporation, be treated as a separate corporation and would impose the lowest effective rate of tax on the income allocated to such branch or similar establishment or to the remainder of the controlled foreign corporation under such section (that is, either paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section). The tested sales location is the location of the purchasing or selling branch or similar establishment or the remainder of the controlled foreign corporation by or through which the purchasing or selling activities are carried on with respect to the personal property. For purposes of this paragraph (b)(1)(ii)(c)(3)(iii), the contribution to the manufacture, production, or construction of the personal property by the tested sales location will be deemed to include the activities of any branch or similar establishment or remainder of the controlled foreign corporation that would not be treated as a corporation separate from the tested sales location after

the application of paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section. For purposes of this paragraph (b)(1)(ii)(c)(3)(iii), the contribution of the tested manufacturing location to the manufacture, production, or construction of the personal property will be deemed to include any activities of any branch or similar establishment or remainder of the controlled foreign corporation that would be treated as a corporation separate from the tested sales location after the application of paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section. Whether the tested sales location provides a greater contribution to the manufacture, production, or construction of the personal property is determined by weighing the relative contributions to the manufacture, production, or construction of that property by the tested sales location and the tested manufacturing location under the facts and circumstances test provided in paragraph (a)(4)(iv) of this section. See paragraph (b)(1)(ii)(c)(3)(v) Examples 3, 4, 5, and 6 of this section. If the tested sales location provides a greater contribution to the manufacture, production, or construction of the personal property than the tested manufacturing location or if there is no tested manufacturing location, then the tested sales location is the location of manufacture, production, or construction of that property and the rules of paragraphs (b)(1)(i)(a) and (b)(1)(ii)(a) of this section will not apply with respect to the income derived by the tested sales location in connection with the purchase or sale of that property and the use of that purchasing or selling branch or similar establishment or the purchasing or selling remainder will not result in a branch being treated as a separate corporation for purposes of paragraph (b)(2)(ii) of this section.

(iv) Location of activity. For purposes of paragraph (b)(1)(ii)(c)(3) of this section, the location of any activity with respect to the manufacture, production, or construction

of an item of personal property is the location where the employees of the controlled foreign corporation perform such activity. For example, the location of any activity concerning intellectual property is determined based on where employees of the controlled foreign corporation develop or direct the use or development of the intellectual property, not on the formal assignment of that intellectual property.

(v) Examples. The following examples illustrate the application of this paragraph (b)(1)(ii)(c)(3):

Example 1. Multiple branches contribute to the manufacture of a single product, only one branch satisfies paragraph (a)(4)(i). (i) Facts. FS is a controlled foreign corporation organized in Country M. FS operates three branches, Branch A, Branch B, and Branch C, located respectively in Country A, Country B, and Country C. Branch A, Branch B, and Branch C each performs different manufacturing activities with respect to the manufacture of Product X. Branch A, through the activities of employees of FS located in Country A, designs Product X. Branch B, through the activities of employees of FS located in Country B, provides quality control and oversight and direction. Branch C, through the activities of employees of FS located in Country C, manufactures Product X (within the meaning of paragraph (a)(4)(ii) or (a)(4)(iii) of this section) using the designs developed by Branch A and under the oversight of the quality control personnel of Branch B. The activities of Branch A and Branch B do not independently satisfy paragraph (a)(4)(i) of this section. Employees of FS located in Country M purchase the raw materials used in the manufacture of Product X from a related person and control the work-in-process and finished goods throughout the manufacturing process. Employees of FS located in Country M also manage the manufacturing costs and capacities related to Product X. Further, employees of FS located in Country M oversee the coordination between the branches. The activities of the remainder of FS in Country M do not independently satisfy paragraph (a)(4)(i) of this section. Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. The sales income from the sale of Product X is taxed in Country M at an effective rate of tax of 10%. Country C imposes an effective rate of tax of 20% on sales income.

(ii) Result. Country C is the location of manufacture for purposes of applying paragraph (b)(1)(ii)(b) of this section because only the activities of Branch C independently satisfy paragraph (a)(4)(i) of this section. The use of Branch C has substantially the same tax effect as if Branch C were a wholly owned subsidiary corporation of FS because the effective rate of tax on the sales income (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch C is located (20%). Therefore, sales of Product X by the remainder of FS are treated as sales on behalf of

Branch C. In determining whether the remainder of FS will qualify for the manufacturing exception under paragraph (a)(4)(iv) of this section, the activities of FS will include the activities of Branch A or Branch B, respectively, if each of those branches would not be treated as a separate corporation under paragraph (b)(1)(ii)(b) of this section, if that paragraph were applied independently to each of Branch A and Branch B. See paragraph (b)(2)(ii)(a) of this section.

Example 2. Multiple branches satisfy paragraph (a)(4)(i) with respect to the same product sold by the controlled foreign corporation. (i) Facts. Assume the same facts as in Example 1, except for the following. In addition to the design of Product X, Branch A also performs in Country A other manufacturing activities, including those ascribed to FS in Example 1, that are sufficient to qualify as manufacturing under paragraph (a)(4)(iv) of this section with respect to Product X. Country A imposes an effective rate of tax of 12% on sales income.

(ii) Result. Branch A and Branch C through their activities each independently satisfy the requirements of paragraph (a)(4)(i) of this section. Therefore, paragraph (b)(1)(ii)(b) of this section is applied by comparing the effective rate of tax imposed on the income from the sales of Product X against the lowest effective rate of tax that would apply to the sales income in either Country A or Country C if paragraph (b)(1)(ii)(b) of this section were applied separately to Branch A and Branch C. Country A imposes the lower effective rate of tax, and therefore, Branch A is treated as the location of manufacture for purposes of applying paragraph (b)(1)(ii)(b) of this section. The effective rate of tax in Country B is not considered because Branch B does not satisfy paragraph (a)(4)(i) of this section. Neither Branch A nor Branch C is treated as a separate corporation because the effective rate of tax on the sales income of FS from the sale of Product X (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch A is located (12%). Sales of Product X by the remainder of the controlled foreign corporation are not treated as made on behalf of any branch.

Example 3. Determining the location of manufacture when manufacturing activities performed by multiple branches and no branch independently satisfies paragraph (a)(4)(i). (i) Facts. FS, a controlled foreign corporation organized in Country M, purchases raw materials from a related person. The raw materials are manufactured (under the principles of paragraph (a)(4)(ii) or (a)(4)(iii) of this section) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion of the raw materials in Country C. FS has two branches, Branch A and Branch B, located in Country A and Country B respectively. Branch A, through the activities of employees of FS located in Country A, designs Product X. Branch B, through the activities of employees of FS located in Country B, controls manufacturing related logistics, provides oversight and direction during the manufacturing process, and controls the raw materials and work-in-process. FS manages the manufacturing costs and capacities related to the manufacture of Product X through employees located in Country M. Further, employees of FS located in Country M oversee the coordination between the

branches. Employees of FS located in Country M also sell Product X to unrelated persons for use outside of Country M. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 20%, and Country B imposes an effective rate of tax on sales income of 24%. Neither the remainder of FS, nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section. However, under the facts and circumstances of the business, FS as a whole provides a substantial contribution to the manufacture of Product X within the meaning of paragraph (a)(4)(iv) of this section.

(ii) Result. Based on the facts, neither the remainder of FS (through the activities of its employees in Country M) nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provides a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch A is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country A (20%), and Country A has the lowest effective rate of tax among the manufacturing branches that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. The activities of Branch B will be included in the contribution of Branch A for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country B (24%). Under the facts and circumstances of the business, the activities of the remainder of FS would not provide a greater contribution to the manufacture of Product X than the activities of Branch A and Branch B, considered together. Therefore, the location of manufacture is Country A, the location of Branch A.

Example 4. Manufacturing activities performed by multiple branches, no branch independently satisfies paragraph (a)(4)(i), selling activities carried on by remainder of the controlled foreign corporation, remainder contribution includes branch manufacturing activities. (i) Facts. The facts are the same as Example 3, except that the effective rate of tax on sales income in Country B is 12%. In addition, under the facts of the particular business, the activities of employees of FS located in Country B and Country M, if considered together, would provide a greater contribution to the manufacture of Product X than the activities of employees of FS located in Country A.

(ii) Result. Based on the facts, neither the remainder of FS (through activities of its employees in Country M) nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provide a contribution

through the activities of their employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch A is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country A (20%), and Branch A is the only branch that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. The activities of Branch B will be included in the contribution of the remainder of FS for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by Country M (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country B (12%). Under a facts and circumstances analysis, considered together, the activities of Branch B and the remainder of FS would provide a greater contribution to the manufacture of Product X than the activities of Branch A. Therefore, the rules of paragraph (b)(1)(ii)(a) of this section will not apply with respect to the income derived by the remainder of FS in connection with the sale of Product X, and neither Branch A nor Branch B will be treated as a separate corporation for purposes of paragraph (b)(2)(ii) of this section.

Example 5. Manufacturing activities performed by multiple branches, no branch independently satisfies paragraph (a)(4)(i), sales carried on by remainder of the controlled foreign corporation and a sales branch. (i) Facts. The facts are the same as Example 3, except that sales of Product X are also carried on through Branch D in Country D, and Country D imposes a 16% effective rate of tax on sales income. In addition, under the facts and circumstances of the business, the activities of employees of FS located in Country A and Country M, considered together, would provide a greater contribution to the manufacture of Product X than the activities of employees of FS located in Country B.

(ii) Result. Based on the facts, neither the remainder of FS nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provide a contribution through the activities of their employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. Further, pursuant to paragraph (b)(1)(ii)(c)(1) of this section, paragraph (b)(1)(ii)(c)(3)(iii) of this section must be applied separately to the sales income derived by the remainder of FS and Branch D respectively. The results with respect to the income derived by the remainder of FS in connection with the sale of Product X in this Example 5 are the same as in Example 3. However, paragraph (b)(1)(ii)(c)(3)(iii) of this section must also be applied with respect to Branch D because the sale of Product X is also carried on through Branch D. Thus, for purposes of that sales income, the location of Branch D is the tested sales location. The location of Branch B is the tested manufacturing location because the effective rate

of tax imposed on Branch D's sales income by Country D (16%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country B (24%), and Branch B is the only branch that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. The manufacturing activities performed in Country M by the remainder of FS and the manufacturing activities performed in Country A by Branch A will be included in Branch D's contribution to the manufacture of Product X for purposes of determining the location of manufacture of Product X with respect to Branch D's sales income because the effective rate of tax imposed on the sales income by Country D (16%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country M (10%) and Country A (20%). Under the facts and circumstances of the business, the activities of Branch D, Branch A, and the remainder of FS, considered together, would provide a greater contribution to the manufacture of Product X than the activities of Branch B. Therefore, the rules of paragraph (b)(1)(ii)(a) of this section will not apply with respect to the income derived by Branch D in connection with the sale of Product X and the use of Branch D to sell Product X will not result in a branch being treated as a separate corporation for purposes of paragraph (b)(2)(ii) of this section.

Example 6. Determining the location of manufacture when employees of remainder of controlled foreign corporation travel to location of unrelated contract manufacturer to perform manufacturing activities. (i) Facts. FS, a controlled foreign corporation organized in Country M, purchases raw materials from a related person. The raw materials are manufactured (under the principles of paragraph (a)(4)(ii) or (a)(4)(iii) of this section) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion of the raw materials in Country C. Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. Employees of FS located in Country M engage in product design, manage the manufacturing costs and capacities with respect to Product X, and direct the use of intellectual property for the purpose of manufacturing Product X. Quality control and oversight and direction of the manufacturing process are conducted in Country C by employees of FS who are employed in Country M but who regularly travel to Country C. Branch A, located in Country A, is the only branch of FS. Product design with respect to Product X conducted by employees of FS located in Country A is supplemental to the bulk of the design work, which is done by employees of FS located in Country M. At all times, employees of Branch A control the raw materials, work-in-process and finished goods. Employees of FS located in Country A also control manufacturing related logistics with respect to Product X. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 20%. Neither the remainder of FS nor Branch A independently satisfies paragraph (a)(4)(i) of this section. However, under the facts and circumstance of the business, FS as a whole (including Branch A) provides a substantial contribution to the manufacture of Product X within the meaning of paragraph (a)(4)(iv) of this section.

(ii) Result. Based on the facts, neither the remainder of FS nor Branch A independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS and Branch A each provide a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The tested manufacturing location is the location of Branch A because the effective rate of tax imposed on the remainder of FS's sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country A (20%), and Branch A is the only branch that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. Although the activities of traveling employees are considered in determining whether FS, as a whole, makes a substantial contribution to the manufacture of Product X under paragraph (a)(4)(iv) of this section, the activities of the employees of FS that are performed in Country C are not taken into consideration in determining whether Country M, the jurisdiction under the laws of which FS is organized, is the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. Activities of employees performed outside the jurisdiction in which the controlled foreign corporation is organized and outside a location in which the controlled foreign corporation maintains a branch or similar establishment, are not considered in determining the location of manufacture. Under the facts and circumstances of the business, the activities of employees of FS performed in Country M do not provide a greater contribution to the manufacture of Product X than the activities of employees of FS performed in Country A. Therefore, the location of manufacture is Country A, the location of Branch A.

(4) Use of more than one branch to manufacture, produce, construct, grow, or extract separate items of personal property. For purposes of paragraphs (b)(1)(ii)(c)(2) and (b)(1)(ii)(c)(3) of this section, an item of personal property refers to an individual unit of personal property rather than a type or class of personal property.

(2) * * *

(i) * * *

(b) Activities treated as performed on behalf of the remainder of corporation. (1)

With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal

property manufactured, produced, constructed, grown, or extracted by the remainder of the controlled foreign corporation, be treated as performed on behalf of the remainder of the controlled foreign corporation.

(2) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property (other than property described in paragraph (b)(2)(i)(b)(1) of this section) purchased or sold, or purchased and sold, by the remainder of the controlled foreign corporation (or any branch treated as the remainder of the controlled foreign corporation), be treated as performed on behalf of the remainder of the controlled foreign corporation.

* * * * *

(ii) * * *

(a) Treatment as separate corporations. The branch or similar establishment will be treated as a wholly owned subsidiary corporation of the controlled foreign corporation, and such branch or similar establishment will be deemed to be incorporated in the country in which it is located. For purposes of applying the rules of this paragraph (b)(2)(ii), a branch or similar establishment of a controlled foreign corporation treated as a separate corporation purchasing or selling on behalf of the remainder of the controlled foreign corporation under paragraph (b)(2)(ii)(b) of this section, or the remainder of the controlled foreign corporation treated as a separate corporation purchasing or selling on behalf of a branch or similar establishment of the controlled foreign corporation under paragraph (b)(2)(ii)(c) of this section, will include the activities of any other branch or similar establishment or remainder of the controlled

foreign corporation that would not be treated as a separate corporation (apart from the branch or similar establishment of a controlled foreign corporation that is treated as performing purchasing or selling activities on behalf of the remainder of the controlled foreign corporation under paragraph (b)(2)(ii)(b) of this section or the remainder of the controlled foreign corporation that is treated as performing purchasing or selling activities on behalf of the branch or similar establishment under paragraph (b)(2)(ii)(c) of this section) if the effective rate of tax imposed on the income of the purchasing or selling branch or similar establishment, or purchasing or selling remainder of the controlled foreign corporation, were tested under the principles of paragraph (b)(1)(i)(b) or (b)(1)(ii)(b) of this section against the effective rate of tax that would apply to such income if it were considered derived by such other branch or similar establishment or the remainder of the controlled foreign corporation.

(b) Activities treated as performed on behalf of the remainder of corporation. (1)

With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property manufactured, produced, constructed, grown, or extracted by the remainder of the controlled foreign corporation, be treated as performed on behalf of the remainder of the controlled foreign corporation.

(2) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property (other than property described in paragraph (b)(2)(ii)(b)(1) of this section) purchased or sold, or purchased and sold, by the remainder of the controlled foreign corporation (or any branch treated as the remainder of the controlled foreign

corporation), be treated as performed on behalf of the remainder of the controlled foreign corporation.

* * * * *

(d) [Reserved].

(e) Comparison with ordinary treatment. Income derived by a branch or similar establishment, or by the remainder of the controlled foreign corporation, will not be foreign base company sales income under paragraph (b) of this section if the income would not be foreign base company sales income if it were derived by a separate controlled foreign corporation under like circumstances.

* * * * *

(4) Illustrations. The application of this paragraph (b) may be illustrated by the following examples:

* * * * *

Example 3. (i) Facts. Corporation E, a controlled foreign corporation incorporated under the laws of foreign Country X, is a wholly owned subsidiary of Corporation D, also a controlled foreign corporation incorporated under the laws of Country X. Corporation E maintains Branch B in foreign Country Y. Both corporations use the calendar year as the taxable year. In 1964, Corporation E's sole activity, carried on through Branch B, consists of the purchase of articles manufactured in Country X by Corporation D, a related person, and the sale of the articles through Branch B to unrelated persons. One hundred percent of the articles sold through Branch B are sold for use outside Country X and 90% are also sold for use outside of Country Y. The income of Corporation E derived by Branch B from such transactions is taxed to Corporation E by Country X only at the time Corporation E distributes such income to Corporation D and is taxed on the basis of what the tax (a 40% effective rate) would have been if the income had been derived in 1964 by Corporation E from sources within Country X from doing business through a permanent establishment therein. Country Y levies an income tax at an effective rate of 50% on income derived from sources within such country, but the income of Branch B for 1964 is effectively taxed by Country Y at a 5% rate since under the laws of such country, only 10% of Branch B's income is derived from sources within such country. Corporation E makes no distributions to Corporation D in 1964.

(ii) Result. In determining foreign base company sales income of Corporation E for 1964, Branch B is treated as a separate wholly owned subsidiary corporation of Corporation E, the 5% rate of tax being less than 90% of, and at least 5 percentage points less than the 40% rate. Income derived by Branch B, treated as a separate corporation, from the purchase from a related person (Corporation D), of personal property manufactured outside of Country Y and sold for use, disposition, or consumption outside of Country Y constitutes foreign base company sales income. If, instead, Corporation D were unrelated to Corporation E, none of the income would be foreign base company sales income because Corporation E would be purchasing from and selling to unrelated persons and if Branch B were treated as a separate corporation it would likewise be purchasing from and selling to unrelated persons. Alternatively, if Corporation D were related to Corporation E, but Branch B manufactured the articles prior to sale under the principles of paragraph (a)(4)(iv) of this section, the income would not be foreign base company sales income because Branch B, treated as a separate corporation, would qualify for the manufacturing exception under paragraph (a)(4) of this section.

* * * * *

Example 8. Uniformly applicable incentive tax rate in one country. (i) Facts. FS is a controlled foreign corporation organized in Country M. FS operates one branch, Branch A, located in Country A. Branch A manufactures Product X within the meaning of paragraph (a)(4)(ii) or (a)(4)(iii) of this section. Raw materials used in the manufacture of Product X are purchased by FS from an unrelated person. FS engages in activities in Country M to sell Product X to a related person for use outside of Country M. Employees of FS located in Country M carry on only sales functions. The effective rate imposed in Country M on the income from the sale of Product X is 10%. Country A generally imposes an effective rate of tax on income of 20%, but imposes a uniformly applicable incentive rate of tax of 10% on manufacturing income and related sales income.

(ii) Result. The use of Branch A to manufacture Product X does not have substantially the same tax effect as if Branch A were a wholly owned subsidiary corporation of FS because the effective rate of tax on FS's sales income from the sale of Product X in Country M (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch A is located (10%). Consequently, pursuant to paragraph (b)(1)(ii)(b) of this section, Branch A is not treated as a separate corporation apart from the remainder of FS for purposes of determining foreign base company sales income.

Example 9. Manufacturing activities performed by multiple branches, no branch independently satisfies paragraph (a)(4)(i), selling activities carried on by remainder of the controlled foreign corporation, some branch manufacturing activities included in remainder contribution. (i) Facts. FS, a controlled foreign corporation organized in Country M, has three branches, Branch A, Branch B, and Branch C, located in Country A, Country B, and Country C respectively. FS purchases raw materials from a related

person. The raw materials are manufactured (under the principles of paragraph (a)(4)(ii) or (a)(4)(iii) of this section) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion required to manufacture Product X outside of FS's country of organization. FS manages the manufacturing costs and capacities with respect to the manufacture of Product X through employees located in Country M. Further, employees of FS located in Country M oversee the coordination between the branches. Branch A, through the activities of employees of FS located in Country A, designs Product X, controls manufacturing related logistics, and controls the raw materials and work-in-process during the manufacturing process. Branch B, through the activities of employees of FS located in Country B, provides quality control. Branch C, through the activities of employees of FS located in Country C, provides oversight and direction during the manufacturing process. Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 12%, Country B imposes an effective rate of tax on sales income of 24%, and Country C imposes an effective rate of tax on sales income of 25%. None of the remainder of FS, Branch A, Branch B, or Branch C independently satisfies paragraph (a)(4)(i) of this section. However, under the facts and circumstances of the business, FS, as a whole, provides a substantial contribution to the manufacture of Product X within the meaning of paragraph (a)(4)(iv) of this section. Under the facts and circumstances of the business, the activities of the remainder of FS and Branch A, if considered together, would not provide a greater contribution to the manufacture of Product X than the activities of Branch B and Branch C, if considered together. Under the facts and circumstances of the business, however, the activities of the employees of the remainder of FS and Branch A, if considered together, would constitute a substantial contribution to the manufacture of Product X.

(ii) Result. Based on the facts, neither the remainder of FS (through activities of its employees in Country M) nor any branch of FS independently satisfies paragraph (a)(4)(i) of this section with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, Branch B, and Branch C each provide a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch B is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country B (24%), and Country B has the lowest effective rate of tax among the manufacturing branches that would, after applying paragraph (b)(1)(ii)(b) of this section, be treated as a separate corporation. The manufacturing activities performed in Country A by Branch A will be included in the contribution of the remainder of FS for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by Country M (10%) is not less than 90% of,

and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country A (12%). The manufacturing activities performed in Country C by Branch C will be included in the contribution of Branch B for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country C (25%). Under the facts and circumstances of the business, the manufacturing activities of the remainder of FS and Branch A, considered together, would not provide a greater contribution to the manufacture of Product X than the activities of Branch B and Branch C, considered together. Therefore, the location of manufacture is Country B, the location of Branch B. In determining that Country B is the location of manufacture, it was determined that after applying paragraph (b)(1)(ii)(b) of this section Branch B would be treated as a separate corporation under paragraph (b)(1)(ii)(a) of this section for purposes of determining foreign base company sales income. To determine whether income from the sale of Product X is foreign base company sales income, the remainder of FS takes into account the activities of Branch A because, under paragraph (b)(2)(ii)(a) of this section, Branch A would not be treated as a separate corporation apart from FS. The remainder of FS is considered to have manufactured Product X under paragraph (a)(4)(i) of this section because the manufacturing activities of the remainder of FS and Branch A, considered together, would make a substantial contribution to the manufacture of Product X within the meaning of paragraph (a)(4)(iv) of this section. Therefore, income derived from the sale of Product X by the remainder of FS does not constitute foreign base company sales income.

(c) Effective/applicability date. Paragraphs (a)(1)(i), (a)(1)(iii) Example 1, (a)(1)(iii) Example 2, (a)(2), (a)(4)(i), (a)(4)(ii), (a)(4)(iii), (a)(4)(iv), (a)(6)(i), (b)(1)(i)(c), (b)(1)(ii)(a), (b)(1)(ii)(c), (b)(2)(i)(b), (b)(2)(ii)(a), (b)(2)(ii)(b), (b)(2)(ii)(e), and (b)(4) Example 3, (b)(4) Example 8, and (b)(4) Example 9 of this section shall apply to taxable years of controlled foreign corporations beginning after June 30, 2009, and for taxable years of United States shareholders in which or with which such taxable years of the controlled foreign corporations end.

(d) Application of regulations to earlier taxable years. A taxpayer may choose to apply these regulations retroactively with respect to its open taxable years that began prior to July 1, 2009. The taxpayer may so choose if and only if the taxpayer and all members of the taxpayer's affiliated group (within the meaning of section 1504(a)) apply

these regulations, in their entirety, to the earliest taxable year of each controlled foreign corporation that ends with or within an open taxable year of the taxpayer and to all subsequent taxable years.

§1.954-3T [Removed]

Par. 3. Section 1.954-3T is removed.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved: December 6, 2011.

Emily S. McMahon,
Acting Assistant Secretary of the Treasury (Tax Policy).

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